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Historical tax credits under fire

Developers who renovate old mills and historic buildings are worried about Governor Carcieri's proposal to reduce the preservation tax break.

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In the midst of all the stories about renovation, revitalization and renewal there were always underlying, but largely overlooked, concerns about the cost of the state's historic preservation tax credit program.

Now, Governor Carcieri says the costs can no longer be ignored.

In 2001, the state increased the amount of income tax credits developers can take for revitalizing historic properties to 30 percent of the total value of the project. Spurred by the generous incentive, developers -- many from across the country -- flocked to Rhode Island, unveiling plan after plan to renovate old mills and historic buildings statewide.
It adds up to about $840 million worth of proposed investment that will create condos, apartments, shops, restaurants -- and jobs -- from West Warwick to the Olneyville section of Providence. In return, the developers expect to collect about $148 million worth of historic preservation tax credits from the state by 2007, according to the state budget office.

Since 2004, state legislators have warned about the impact the tax credits could have on state revenue. A one-year moratorium on the program was proposed by legislators in 2004.

Developers said it would stall development. Governor Carcieri called it "short-sighted" and predicted the number of people applying for tax credits would eventually slow down. The moratorium wasn't approved. The number of developers applying for credits continued to increase.

Last month, Governor Carcieri suggested reducing the state's historic tax credit, which is one of the most generous in the nation. The tax credit program is expected to require the state to lose $84.6 million in income during this fiscal year. The state budget office projects it will cost the state $260 million in lost tax revenue by 2011 -- much more than the state expected to shell out for the program. Although Carcieri hasn't yet introduced legislation to change the historic tax credit program, the state budget office is analyzing it.

"The governor's office has had conversations with legislative leaders in which those leaders have expressed the same concerns about the cost of the program," said Jeff Neal, spokesman for

Carcieri. "From those conversations we expect that there's a significant chance that the [General Assembly] will ultimately begin to examine this issue this year."

Earlier this month, House Majority Leader Gordon Fox said that he supports the tax credit program and thinks it is too valuable to put a moratorium on it, but he does think the edges could be "massaged."

All this public discussion about the future of the program has sent chills through the proponents of the credits. Local developers say they are rethinking projects and some say their investors are waiting to see what Carcieri will propose before committing more money. Others, such as Leo Costantino Jr., a West Warwick town councilman, and Scott Wolf, head of Grow Smart Rhode Island, worry what restrictions on the program could mean for the Rhode Island cities and towns that stand to see entire neighborhoods rehabilitated by mill renovations.

"They work. They've been the godsend of the town," said Costantino about the tax credits. West Warwick has a number of mill renovation projects pending, including Baltimore-based Struever Bros. Eccles & Rouse's $80-million overhaul of sprawling, rundown Royal Mills. The company also plans to convert the 118-year-old Crompton Mill in West Warwick into a complex of retail shops, offices and apartments.

But in West Warwick alone, Struever expects to collect at least $22.3 million in income tax credits, according to Grow Smart Rhode Island.

Developers of approved projects receive a tax credit worth 30 percent of the project's renovation costs. The developer can use the credits to offset its own income tax, or sell them to another Rhode Island taxpayer and use the proceeds to fund the project. Although the 20-percent federal historic preservation income tax credit is level in every state, each state has its own credit that can be applied to state income tax. At 30 percent of the project's cost, Rhode Island's credit is considerably higher than most states.

"It's an expensive program, no doubt about it," concedes Costantino. "But it's a savior for towns like mine."

For Grow Smart, the program is what responsible economic growth is all about, said Wolf, Grow Smart's executive director. The statewide public interest group is focused on preserving open space, revitalizing town centers and preventing suburban sprawl. The historic tax credits encourage the preservation of culturally important buildings and reuse existing property, Wolf said. In addition, by turning abandoned mills into complexes of housing, retail shops and offices, developers have the potential to turn bleak neighborhoods into lively, livable urban centers, Wolf said.

"The benefits far outweigh the costs," said Wolf, adding that in many ways the tax credits are an urban aid program. "We think it's the best economic and neighborhood revitalization tool the state has used in decades."

To prove its point, last year, Grow Smart hired a consulting firm to study the economic impact of the tax credits. The study reported, based on the 111 proposed and active projects at the time, that 3,000 permanent jobs would be created at the renovated properties, adding about $242.5 million to the tax base of local communities. Every $1 in state tax credit is creating $5.47 in economic output, according to the study.

Paul Dion, chief budget analyst in the state budget office, though, questions whether this economic output could be created in less expensive ways, and said it's hard to keep the budget impact clear with new projects constantly starting up. The level of applications since the law changed in 2001 has risen 1,000 percent compared with the level of applications before the change, said Edward F. Sanderson, executive director of the Rhode Island Historical Preservation & Heritage Commission.

"It's really difficult to budget when you don't know what's out there," Dion said.
Whatever the economic impact, Sanderson says, the credits have fueled the preservation of historically important buildings and created affordable housing in neighborhoods that people thought would never be redeveloped.

"We are rebuilding the tax bases in communities where we have been losing," Sanderson said. "These are projects that weren't happening on their own."
Sanderson adds that while some more-commercial projects may have been completed without having to return 30 percent of the cost of the project to the developer, some of the nonprofit and low-income housing projects are counting on the credits to stay afloat.

"I think a catastrophic change [in the program] will slow down or kill the development very quickly," Sanderson said.

Some developers agree. Three developers working on mill renovations across the state, which have all qualified for historic tax credits, say they've already started rethinking projects or are hearing from skittish investors.

Construction costs, energy costs and interest rates have shot up over the past few years, while prices for rental units have stayed the same, said Tony Thomas, a partner with Foundry Associates. With costs going up, the money coming back from the income tax credits has become more important than ever, said Thomas.

His company owns The Foundry, Brown & Sharpe Manufacturing Co.'s former manufacturing complex, and has used tax credits to renovate the buildings into offices and apartments. One building remains to be overhauled, and Thomas has slowed the renovation of that last building while he waits to see what happens with the tax credit program.

"Some [developers] are frustrated because they've tied these properties up and spent a lot of money with the expectation that they are going to have the benefit of the program," Thomas said. "Any major adjustment to that credit is going to hurt, it's going to put a lot of projects that are under way in jeopardy."

Mike Corso, general counsel for Cornish Associates, which is working on a major redevelopment in the Downcity section of Providence, said there are some projects the company is reconsidering. And John Sinnott, senior development director with Struever said some investors have expressed concern about how changes in the tax credit program will impact projects.

"It's more difficult for us to prove that things are going to work out, so they are very hesitant," said Sinnott. "We haven't had anybody pull out, but we hadn't had anyone jump in."

The developers say that they understand the program is expensive, but add that they think it's an important way to invest in the state's economic development.
"It's very easy to book the tax revenue loss. But the question is how do you book the other side, the new residents, new businesses and new sales tax? You're getting money returned to the state before the projects are done," Corso said.

It's still unclear what the state's proposal will be for the program this year. Already some changes have been made since the increase in 2001. Last year, the state implemented a processing fee adding up to 2.25 percent of the project's total value.

However, Rhode Island is facing a $222-million projected budget deficit in fiscal year 2007, and is looking hard for ways to cut state costs. While Carcieri has said that he doesn't want any alterations to the program to effect projects already being developed, he does expect to discuss changes to the program with the General Assembly this legislative session, said Neal with the governor's office.

"The governor has long recognized the value of the state's historic tax credits, he also recognized the credits come at a considerable cost," Neal said.
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